

United States Bankruptcy Court
Eastern District of Michigan
Southern Division

In re:

Richard Keith Carlson,
Debtor.

Case No. 05-69540-R
Chapter 7

Gene R. Kohut, Trustee for the Estate of
Kelly R. Carlson,
Plaintiff,

v.

Adv. No. 05-05779

Richard Keith Carlson,
Defendant.

Opinion Regarding Cross Motions for Summary Judgment

This matter is before the Court on cross motions for summary judgment. The Court conducted a hearing on May 22, 2006, and took the matter under advisement.

I.

Richard and Kelly Carlson divorced in 2002. As part of the divorce settlement, Richard was obligated to pay Kelly \$28,000. If he did not do so within 30 days, Richard would be obligated to sell the marital home and Kelly would receive one half of the net proceeds of the sale. Richard did not pay Kelly \$28,000. In 2003, Richard sold the home. According to the closing statement, there were no net proceeds from the sale of the home. Thus, Kelly received nothing.

Kelly filed a chapter 7 petition in 2004. Gene Kohut, the trustee in Kelly's case, filed an adversary

proceeding against Richard alleging that Richard improperly converted assets from the sale of the home, thus depriving Kelly of her share of the sale proceeds. In that adversary proceeding, Bankruptcy Judge McIvor determined that net proceeds, amounting to \$73,871.43, should have been available from the sale. However, Richard paid those funds to Carlson Homes, Inc., for additional costs incurred in building the home. The court entered a judgment in favor of Kohut against Richard for half of that amount, or \$36,935.71, for common law conversion. *See Kohut v. Carlson*, Case No. 03-72715, AP No. 04-4420, slip op., October 28, 2004.

On September 12, 2005, Richard filed this chapter 7 case. On October 17, 2005, Kohut, in capacity as trustee of Kelly's bankruptcy case, filed this adversary proceeding seeking a determination that the judgment entered against Richard is nondischargeable under 11 U.S.C. § 523(a)(2)(A) and § 523(a)(4).

II.

Kohut contends that res judicata applies to the prior judgment to render it nondischargeable under § 523(a)(2)(A). Kohut asserts that Richard lied to Kelly when he told her that there were no proceeds available from the sale of the home to pay to her. Further, Kohut argues that Richard knew he was lying to Kelly and that he was not legally obligated to pay any proceeds from the sale to Carlson Homes. Kohut also argues that Richard intended to deceive Kelly and that Kelly justifiably relied on Richard's representation that there were no net proceeds.

In support of his request for summary judgment under § 523(a)(4), Kohut asserts that Richard's actions constitute embezzlement or larceny. Kohut contends that the bankruptcy court found conversion,

which is a distinct act of dominion asserted over another's personal property that is committed by intentionally dispossessing another of a chattel, or refusing to surrender a chattel on demand. Kohut argues that this finding meets the elements of both embezzlement and larceny.

The debtor contends that § 523(a)(2)(A) is inapplicable because he never received any money, property, or services. The debtor argues that all of the proceeds from the sale were used to pay closing and construction costs. The debtor further asserts that he did not make any misrepresentations, and even if he did, there is no evidence that he knew the representations were false or made them with gross recklessness as to their truth. The debtor contends that any representations made by him regarding proceeds from the sale were based on his belief that the costs of construction took precedence over his obligations to his ex-wife. The debtor asserts that, due to the construction liens, the closing could not have occurred if the construction costs had not been satisfied. The debtor also argues that there was no intent to deceive on his part. He contends that he did what he believed was the right thing to do.

With respect to § 523(a)(4), the debtor contends that because he has not been accused or convicted of larceny or embezzlement, there is no basis for a finding of nondischargeability under § 523(a)(4).

III.

Section 523(a)(2) states in pertinent part:

A discharge under section 727 . . . of this title does not discharge an individual debtor from any debt--

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by--

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition.

11 U.S.C. § 523(a)(2)(A).

In order to except a debt from discharge under § 523(a)(2)(A) for a false representation, a creditor must prove the following elements: (1) the debtor obtained money through a material misrepresentation that, at the time, the debtor knew was false or made with gross recklessness as to its truth; (2) the debtor intended to deceive the creditor; (3) the creditor justifiably relied on the false representation; and (4) its reliance was the proximate cause of loss. *See Longo v. McLaren (In re McLaren)*, 3 F.3d 958, 961 (6th Cir. 1993).

Section 523(a)(4) can also involve “actual fraud,” which is defined as “any deceit, artifice, trick or design involving direct and active operation of the mind, used to circumvent and cheat another.” *McClellan v. Cantrell*, 217 F.3d 890, 893 (7th Cir. 2000) (quoting 4 *Collier on Bankruptcy* ¶ 523.08[1][e], p. 523-45 (15th ed., Lawrence P. King ed., 2000)).

Section 523(a)(4) excepts from discharge a claim for “fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny[.]”

A creditor must prove each of the elements by a preponderance of the evidence. *See Grogan v. Garner*, 498 U.S. 279, 291, 111 S. Ct. 654, 661 (1991).

Kohut asserts that collateral estoppel precludes the debtor from relitigating the issues previously determined by Judge McIvor. Under the doctrine of collateral estoppel, “once an issue is actually and necessarily determined by a court of competent jurisdiction, that determination is conclusive in subsequent

suits based on a different cause of action involving a party to the prior litigation.” *Montana v. United States*, 440 U.S. 147, 153, 99 S. Ct. 970 (1979). Collateral estoppel applies where the following conditions are met: (1) the issue in the subsequent litigation is identical to that resolved in the earlier litigation; (2) the issue must have been actually litigated and decided in the prior action; (3) the issue must have been necessary and essential to a judgment on the merits in the prior litigation; and (4) the party to be estopped was a party to the prior litigation or in privity with such party. *United States v. Real Property Known and Numbered as 415 E. Mitchell Ave.*, 149 F.3d 472, 476 (6th Cir. 1998). Bankruptcy courts can apply the doctrine of collateral estoppel to avoid relitigating any grounds for nondischargeability that were previously litigated in a prior proceeding. *Spilman v. Harley*, 656 F.2d 224, 227 (6th Cir. 1981).

In the prior proceeding, Judge McIvor found Richard liable for common law conversion. “Under Michigan law ‘conversion’ is defined as ‘a distinct act of dominion wrongfully exerted over another’s personal property . . . [that is] committed by . . . intentionally dispossessing another of a chattel, . . . [or] . . . refusing to surrender a chattel on demand . . .’” *Clark & Gregory, Inc. v. Hanson (In re Hanson)*, 225 B.R. 366 (Bankr. W.D. Mich. 1998) (quoting *Borock v. Mathis (In re Clipper International Corporation)*, 154 F.3d 565 (6th Cir. Mich. 1998).

With respect to the § 523(a)(2)(A) count, the Court concludes that Judge McIvor’s finding of conversion does not provide a basis for a finding of nondischargeability under § 523(a)(2)(A). Judge McIvor’s opinion does fairly establish that Richard did obtain the money through a material misrepresentation, i.e., that there were no proceeds available because the additional construction costs had to be paid first. However, there was no finding that the debtor knew the misrepresentation was false or

that the debtor's ex-wife reasonably relied on the misrepresentation. Further, there is no evidence of actual fraud. Accordingly, Kohut's motion for summary judgment on this claim is denied.

Kohut next argues that Judge McIvor's opinion establishes larceny or embezzlement and that the debt is therefore nondischargeable under § 523(a)(4). Kohut asserts that the debtor committed larceny by trick, which requires proof of (1) a criminal taking of property by means of fraudulent contrivances rather than by trespass, (2) when the true owner has no intention of giving ownership but only intends to give up possession. *People v. Styles*, 233 NW2d 70 (Mich. App. 1975).

[F]or Section 523(a)(4) purposes, federal common law, rather than state law, controls the meaning of these terms. *Brady v. McAllister (In re Brady)*, 101 F.3d 1165, 1172-73 (6th Cir. 1996). Federal common law defines embezzlement as "the fraudulent appropriation of property by a person to whom such property has been entrusted or into whose hands it has lawfully come." *Id.* Larceny is different in that the original taking must have been unlawful, and is defined as "the fraudulent and wrongful taking and carrying away of the property of another with intent to convert such property to the taker's use without the consent of the owner." *Graffice v. Grim (In re Grim)*, 293 B.R. 156, 166 (Bankr. N.D. Ohio 2003).

Williams v. Noblit (In re Noblit), 327 B.R. 307, 311 (Bankr. E.D. Mich. 2005).

The Court concludes that Judge McIvor's opinion does not establish the elements for either larceny or embezzlement. Accordingly, Kohut's motion for summary judgment on his § 523(a)(4) claim is denied.

The debtor filed a cross-motion for summary judgment seeking to have the complaint dismissed. However, the debtor has not provided any support for that request. Accordingly, his motion for summary judgment is also denied.

NOT FOR PUBLICATION

Entered: July 06, 2006

/s/ Steven Rhodes

Steven Rhodes

Chief Bankruptcy Judge